

# **Underwriting; Development of the Restructuring Plan**

## **Executive Summary**

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### **SECTION 5-1**

This chapter describes the financial underwriting of the M2M transaction and the development of the Restructuring Plan. The PAE will determine the project's rents, expenses, and deposits to the reserves under various scenarios. The PAE will then size the first and second mortgages, and third mortgage, if needed, and determine the amount of claim payable by FHA, as well as the sources and uses in the transaction, and the owner's financial return. The results of this underwriting, the due diligence described in Chapter 4, the tenant comments, and owner negotiations are consolidated in the draft Restructuring Plan Package submitted to the OMHAR Regional Office. The PAE should work cooperatively with the owner and lender as needed throughout this process.

## **Underwriting Model**

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### **SECTION 5-2**

- A. **General.** OMHAR has provided an Underwriting Model for use in completing the financial underwriting of M2M transactions. A copy of the Model is available on OMHAR's Web site or can be obtained through the OMHAR Regional Office. Use of the Model is optional. However, PAEs to date have used the Model as it helps meet the unique requirements of this program, which will not be present in other underwriting models. The Model is only an aid and may not be appropriate or complete for every case; the PAE remains responsible for their own conclusions, regardless of whether the Model is used or not.

- B. **Using the Model.** Specific problems or questions on using the Model should be addressed to the Resource Desk. PAEs may wish to start initial inputs into the Model as early in the process as the information becomes available to expedite completion of the underwriting when all data is available. Since the Model provides space for comments, PAEs can save time and effort by including brief comments in the Model that do not have to be duplicated in narrative sections of the Restructuring Plan Package.
- C. **MIS Input.** The Model provides a summary data page for use in completing the required electronic submissions to OMHAR.

## **Income**

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### SECTION 5-3

- A. **Estimate Gross Potential Rental Income Two Ways.**
  - 1. Income Based on Comparable Market Rents. Estimate gross potential rental income by applying the market comparable rents to all units in the property, whether assisted or unassisted.
  - 2. Income Based on Affordable (Tax Credit) Rents. Estimate an alternate income by applying one of the Low-Income Housing Tax Credit (LIHTC) standards below. Choose the LIHTC standard that yields higher income.
    - a) 20% of units with rents equal to 30% times 50% of Area Median Income, or
    - b) 40% of units with rents equal to 30% times 60% of Area Median Income.
- B. **Commercial Income.** Estimate gross commercial income after a review of existing leases, information supplied by the appraiser, and any other information available to the PAE. Show income from each commercial unit separately. If a current lease rent is less than market, use the current lease rent. Do not include income from commercial space that has been standing vacant for any significant period of time.
- C. **Other Income.** Estimate other income from such sources as laundry facilities, parking, cable TV, and washer/dryer rental. Use income from these sources only if it is common in the market and the project's operating statements demonstrate a history of consistent income that is likely to continue.

## Physical and Economic Vacancy

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### SECTION 5-4

#### A. Residential Vacancy and Bad Debt/Collection Loss Factor.

1. Review the project's historical occupancy performance, market comparables, and other market information including the supply of competitive housing in the market.
2. If the RAAP determines that tenant-based assistance is appropriate, use a market vacancy rate and bad debt factor.
3. If the RAAP determines that project-based assistance is appropriate, generally use the market rate. Exceptions may be made where the market vacancy rate and bad debt factor has a major negative impact on the loss to HUD. In these cases, after considering all relevant factors, the PAE may determine that the risk associated with using a lower vacancy rate is tolerable. In no case may the PAE use less than the project's historical trend would dictate.
4. Minimums. The minimum residential physical vacancy rate is 5%. The minimum bad debt/collection loss factor is 2%.

#### B. Commercial Vacancy and Bad Debt/Collection Loss Factor.

Estimate separate physical and bad debt/collection loss factors for the commercial space based on historic performance, market information, and trends in the market. The minimum commercial physical vacancy rate is 10%. The minimum bad debt/collection loss factor is 5%.

## Operating Expenses

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### SECTION 5-5

A. **Estimate Operating Expenses.** Analyze operating expenses using the historical expenses from the property's audited financial statements, Limited Scope Appraisal, the underwriter's own sources of data, information from HUD, the owner, and other available and appropriate sources. Examples of appropriate sources include property management firms, utility companies, taxing bodies, and service providers.

#### B. General Approach.

1. Expense estimates should be made for two scenarios: project-based assistance and tenant-based assistance.
2. Expenses should be estimated by individual line item.
3. Expenses based on property history should be trended to the anticipated time of closing under the M2M program.

4. Expense estimates should be based on the average of prior years *only* where trends are not apparent and the basis for annual increases or decreases cannot be ascertained.
5. Comparison to industry averages for comparable market-rate projects should be addressed if the PAE considers it useful to the analysis. Information can be obtained from publications by such entities as local apartment owners associations, IREM, and Dollars and Cents.

**C. Guidance on Individual Expense Items**

1. Capital Recovery Payment. The PAE should calculate this payment based on the requirements in Chapter 3, Section 3-6 and include it as an “expense” in underwriting.
2. Management Fees. Determine a Management Fee for use in underwriting by obtaining information from management entities, appraisers, similar properties, or other sources, on fees currently paid in the market at comparable properties and adjust as necessary. The management fee should:
  - a) be based on the cost that a competent, independent, non-Identity of Interest management agent would bid;
  - b) assume an affordable property with project-based assistance or tenant-based assistance, as appropriate;
  - c) consider any range of fees that has been identified recently by the HUD Multifamily Hub or Program Center. Do not exceed the HUD maximum, if current;
  - d) not be set so low that only the largest and most cost-efficient agents, or agents unable to provide adequate services, could manage profitably; and
  - e) consider the size of the property relative to any comparables used.
3. Accounting/Bookkeeping. Properties with FHA insured loans are allowed to hire bookkeepers as part of the property’s on-site staff, paid as a property expense, to perform accounting tasks. These transactions may also have accounting functions performed centrally by the property management firm with the appropriate share charged back to the property (not to exceed a market cost). These expenses may be included in underwriting where FHA insurance is contemplated.

4. Payroll. Assume adequate but not excessive staffing. If current staffing is high, consider whether this is due to unusual needs at the property or whether the management should be required to reduce staffing expenses as a condition of the Restructuring Plan.
5. Non-Revenue Units. Estimate a number of non-revenue units that is appropriate for the size and type of property. In some instances, this number may be higher than typical because lower occupancy makes it desirable to give discounted units in lieu of salary. Assure that only units with rents included in the gross income estimate are expensed.
6. Turnover Expenses. Assure that the estimate of turnover expenses reflects anticipated turnover and vacancy assumptions.
7. Repair and Maintenance. Assure that these expenses are adequate to maintain the property (i.e., if the property was not properly maintained prior to M2M, the expense used in underwriting should be higher than historic). Assure that there is no duplication with items included in the Reserves for Replacements.
8. Hazard Insurance. The owner is required to maintain a comprehensive policy of hazard insurance with claims payable on a replacement cost basis. The face amount of the policy must meet or exceed HUD's minimum coverage of no less than 80% (or a higher percentage required by the insurer's coinsurance clause) of the project's "Total (100%) Insurable Value", as defined below. The policy must also be subject to an agreed amount clause (insurer agrees on the replacement cost of the insured property).

"Total (100%) Insurable Value" is the greatest of the following:

- a) A current replacement cost estimate of structures and equipment, if available (OMHAR does not require development of replacement cost, but an estimate may be available from the owner, insurer or lender);
- b) The most recent replacement cost estimate of structures and equipment for the project on which required insurance coverage was based prior to the restructuring (obtain the latest updated HUD-92329 Property Insurance Schedule from the owner or from the HUD project files). If significant improvements affecting replacement cost are required as part of the restructuring (e.g., addition of central air conditioning if none before) add the cost of those items; or
- c) The total of all project debt resulting from the M2M full debt restructuring at closing.

9. Security/Protection Expenses. Include security expenses to the extent that such costs are reasonably necessary for a competent agent to operate the property at the level of comparable market expenses. These expenses may be higher or lower than historical expenses.
  10. Neighborhood Networks and Other Non-Housing Service Costs. Include these costs to the extent that the services are effective and that such costs are reasonably necessary to operate the property, taking into account such factors as the current and anticipated resident profile.
- D. **Expenses for Tenant-based Properties.** In developing alternative expenses as a tenant-based property, base the expenses on similar market-rate properties. Especially likely changes are increases in advertising/marketing expenses and reductions in management and administrative fees.

## **Net Operating Income (NOI) for Calculating the First Mortgage**

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### SECTION 5-6

#### **A. Net Operating Income (NOI).**

1. Tenant-based Assistance. Where the RAAP (see Section 4-13) determines that project-based assistance *should not* continue, NOI should always be determined using
  - a) the lower of market rents or affordable rents and
  - b) tenant-based expenses.
2. Project-based Assistance. Where the RAAP (see Section 4-13) determines that project-based assistance is appropriate, NOI should be determined using
  - a) the lower of market rents or affordable rents and
  - b) project-based expenses.
3. Deposits to Replacement Reserves. In all cases, treat the annual deposit to the replacement reserve (see Section 4-11) as an expense in determining NOI.
4. Capital Recovery Payment. In all cases, treat the Capital Recovery Payment (see Section 4-11) as an expense in determining NOI.

#### **B. Analyze the Resulting NOI.**

1. Positive NOI. If the NOI is positive, the PAE should use the NOI determined above to size the first mortgage. Note that a different

NOI may be used to size the second mortgage in some cases (see Section 5-10 below).

2. Inadequate or Negative NOI. If NOI is negative (income less than expenses), or proves insufficient to support financing for rehabilitation costs *with a full pay-down* of the existing first mortgage, the underwriter may consider exception rents (see Section 5-12 below) or rejection of the restructuring plan (see Chapter 6).

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## General Considerations in Structuring the Mortgages

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### SECTION 5-7

The PAE should use its best judgment in developing the restructuring plan to balance the following overall objectives:

- A. The principal financial goal is to establish a supportable first mortgage with a reasonably low likelihood of future default considering the property's market, condition, competition, and the resources of the owner.
- B. The overall structure must include a modest but reasonable return to the owner, sufficient to maintain interest in operating a sound, decent property without excess return regardless of past levels of return.
- C. The second mortgage should be reasonably repayable (as defined below) with the most favorable terms for the government that do not imperil the first mortgage or cause owner disinterest in the property.

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## First Mortgage

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### SECTION 5-8

- A. **Determine the First Mortgage.** The first mortgage should be sized assuming the NOI determined by the PAE above (Section 5-6) and the limitations or considerations discussed in this section.
- B. **Terms.** PAE should assume full amortization and fixed monthly payments based on competitive terms. As soon as a lender is identified, the PAE should get the likely rate and terms from the lender and document that the terms are competitive.
- C. **Debt Service Coverage.** The PAE should generally select a Debt Service Coverage Ratio (DSCR) between 1.2 and 1.4.
  1. The DSCR should be adjusted upward, if necessary, so that the pro forma underwriting permits payment of the full Incentive Performance Fee (see Chapter 3-6 B) in the initial year.

2. In selecting a DSCR, the PAE should consider the following and may make adjustments accordingly:
  - a) The smaller the dollar amount of net operating income, the higher the DSCR that may be appropriate in order to provide adequate cash flow to cover contingencies.
  - b) Where the RAAP has determined that project-based assistance is appropriate, and the *affordable rents are lower* than the market rents, it may be appropriate to adjust the DSCR downward to account for the fact that market rents will be paid under project-based assistance, at least initially. The DSCR must never be lower than would allow minimal coverage in the event that Section 8 payments at the market rents became unavailable.
  - c) The PAE should consider the strength and depth of the market, the competition the project currently faces, the probability of increased competition from new projects, and the owner's motivation and ability (including liquidity) to finance necessary repairs, replacements and major maintenance items in case the reserves are depleted.
- D. **Loan to Value.** The Loan to Value ratio may not exceed 100%. More stringent terms may be imposed by the financing vehicle chosen.
- E. **Small Loans.** In cases where the supportable debt is less than \$250,000, the PAE may consider a complete write off of the first mortgage (thereby increasing the size of the “second” mortgage). This approach is likely to be appropriate where no cost effective sources are available for loans of this size. The PAE should provide support for such a write-off and should consider an increase in the interest rate of the “second” mortgage. With appropriate support, the PAE may propose a write down in cases where the supportable debt is larger than \$250,000.

## Sizing the Partial Payment of Claim

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### SECTION 5-9

- A. The claim must be the lesser of:
  1. the unpaid principal balance (UPB) of an insured or HUD-held first mortgage prior to restructuring, or
  2. the result of the following calculation:
    - a) the UPB on the existing first mortgage;
    - b) plus the rehabilitation costs approved by the PAE;



- c) plus the Initial Deposit to the Reserve for Replacement;
- d) plus the transaction costs approved by the PAE;
- e) plus up to 10% of Excess Project Accounts (see Section 5-13, A.3) approved by the PAE for payment to the owner;
- f) minus the restructured first mortgage (or supportable debt) determined by the PAE;
- g) minus all contributions made by the owner (and the owner's partners/investor) in connection with the restructuring, as determined by the PAE;
- h) minus all Project Accounts (total account balances of the Reserve for Replacement, Residual Receipts and any other applicable accounts at the time of closing), as determined by the PAE. (See also Section 5-13.)

## **Sizing the M2M Subordinate Debt**

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### **SECTION 5-10**

**A. In General.** The total amount of M2M subordinate debt (2<sup>nd</sup> and, where applicable, 3<sup>rd</sup> mortgages) should be determined in accordance with this section. The M2M Underwriting Model (version 4.2 and higher) reflects the provisions of this section. The formula for total M2M subordinate debt varies depending on whether the property has an FHA-insured or HUD-Held mortgage, and whether residual receipts are used to help finance the restructuring.

**B. New Reg Residual Receipts.**

1. Definition. Some Section 8 New Construction / Substantial Rehabilitation properties, developed under the November 1979 “new” Section 8 regulations, have Section 8 HAP Contracts that impose distribution limitations and require that Surplus Cash over and above the limited distribution be deposited into a residual receipts account. 24 CFR 880.205(e) provides that those funds (“new reg residual receipts”) belong to HUD at the end of the HAP Contract’s term.
2. Use of New Reg Residual Receipts in M2M. In M2M transactions, HUD uses those “new reg residual receipts” funds to reduce the partial payment of claim that would otherwise have to be paid. Because these funds are HUD funds, they must be included in the M2M subordinate debt (that is, they are treated as if they were PPC funds).

3. Potential Owner Share. Under Section 5-14.B.4, the PAE may propose that the owner receive up to 10% of Excess Project Accounts. The amount of “new reg residual receipts” included in the M2M subordinate debt is the total amount, less any percentage paid to the owner in accordance with Section 5-14.B.4.
- C. **Other Residual Receipts.** Residual receipts, other than “new reg” residual receipts, will also be used as a source of funds in the restructure (a portion may be released to the owner; see Section 5-14.B.4). However, these funds will not be included in the M2M subordinate debt.
- D. **Restructures of FHA-Insured Mortgages.** The total amount of M2M subordinate debt is calculated as follows:
  1. Partial payment of claim.
  2. Plus any “new reg residual receipts” not distributed to the owner (see Section 5-14.B.4 regarding potential owner share).
- E. **Restructures of HUD-Held Mortgages.** The total amount of M2M subordinate debt is calculated as follows:
  1. Pre-M2M unpaid principal balance (including accrued interest and accrued Servicing Fees) of the HUD-Held mortgage loan.
  2. Plus any “new reg residual receipts” not distributed to the owner (see Section 5-14.B.4 regarding potential owner share).
  3. Minus (for transactions in which the HUD-Held loan is modified at the M2M closing) the principal amount of any modified HUD-Held 1<sup>st</sup> mortgage.
  4. Minus any cash proceeds of closing paid to FHA. FHA will receive cash proceeds from the M2M closing whenever the take-out 1<sup>st</sup> mortgage (and other cash sources) exceed approved uses (such as HUD’s share of the rehab escrow, IDRR and transaction costs).

## Second Mortgage

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### SECTION 5-11

#### A. Terms.

1. The interest rate on the second mortgage is generally 1%. The PAE may require a higher interest rate, whenever both the 2<sup>nd</sup> and 3<sup>rd</sup> mortgages can be fully repaid, using no more than 80% of the property’s estimated residual value. When proposing a higher interest rate, the PAE should increase the interest rate in 0.50% increments. However, in no case can this rate exceed the Applicable Federal

Rate, as published monthly by the Internal Revenue Service. (The Rate is available from the IRS monthly Bulletins and from several commercial web sites such as [www.timevalue.com](http://www.timevalue.com)).

2. The term and maturity date of the second mortgage must be the same as the term and maturity date of the restructured first mortgage. If there is no first mortgage under the restructuring, the maximum second mortgage term is 30 years, but the second mortgage term may not exceed 75% of the remaining economic life of the property.

**B. Funds to Service the Second Mortgage.**

1. For underwriting purposes, at least 75% of NOI minus first mortgage debt service, any Capital Recovery Payment, and Incentive Performance Fee, must be applied toward the second mortgage. The remainder will go to the owner.
2. The PAE may increase the percentage applied to the second mortgage (the “split”) if the PAE determines that the return to the owner is otherwise adequate.

**C. Sizing the Second Mortgage: Restructures of FHA-Insured Mortgages.** Except as provided in paragraph F below, the size of the second mortgage must equal the lesser of:

1. The total amount of M2M subordinate debt (see section 5-10).
2. The greater of the following:
  - a) the Full or Partial Payment of Claim or
  - b) the difference between the UPB of the existing insured mortgage immediately before restructuring and the UPB of the restructured or new first mortgage.
3. An amount the PAE determines the project can reasonably be expected to repay.

**D. Sizing the Second Mortgage: Restructures of HUD-Held Mortgages.** Except as provided in paragraph F below, the size of the second mortgage must equal the lesser of:

1. The total amount of M2M subordinate debt (see section 5-10).
2. The difference between the UPB of the existing HUD-Held mortgage immediately before restructuring and the UPB of the restructured or new first mortgage,
3. An amount the PAE determines the project can reasonably be expected to repay.

**E. Criteria for Determining the Amount “Reasonably Expected to be**

**Repaid”.** The PAE will determine the amount that can reasonably be expected to be repaid after considering both:

1. The amount that appears repayable in a pro forma using:
  - a) the income and expenses actually expected to be incurred (e.g., if affordable rents are lower, but the project will have project-based assistance, use the higher market-rate rents even if not used in determining the first mortgage);
  - b) any Capital Recovery Payment, and any Incentive Performance Fee used in sizing the first mortgage;
  - c) an annual adjustment to the rents and expenses. The PAE will determine the amount of the trend and may choose to apply the OCAF percentage. In no case will the trend applied to the income exceed the trend applied to the expenses;
  - d) a likely vacancy rate (including both physical vacancy and collection loss) of no less than 3%, as determined appropriate by the PAE;
  - e) the percentage of Net Cash Flow determined by the PAE in paragraph B. of this Section; and
  - f) the term of any first mortgage. And,
2. The anticipated residual value/refinance potential of the project at the end of the term.

F. **Qualified Non-profit Purchasers.** PAEs may recommend forgiving all or part of second mortgage requirements, or assigning the second mortgages to eligible entities, for all qualified, non-profit purchasers. See Appendix C for definitions, procedures, and requirements.

## Third Mortgage

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### SECTION 5-12

- A. **When Appropriate.** If the total amount of M2M subordinate debt (see Section 5-10) exceeds the principal amount of the second mortgage, HUD may require a third mortgage in the full amount of the difference, or in a lesser amount. The PAE’s recommendation for a third mortgage in a lesser amount, or for no third mortgage, must be documented and justified (it is acceptable for the PAE to provide the documentation in the underwriting model).
- B. **Terms.** Any third mortgage will be subordinate to other HUD-held mortgages, will bear interest at the same rate as the second mortgage and will require no payments until the second mortgage is paid in full.

- C. **Qualified Non-profit Purchasers.** There will be no third mortgage if a qualified non-profit purchaser requests and receives second mortgage relief. See Appendix C for qualified non-profit purchaser definitions, procedures, and requirements. The third mortgage cannot be assigned; see Appendix C, paragraph I.A.

## Exception Rents

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### SECTION 5-13

- A. **General.** Exception rents (available only for full restructuring transactions) are:
1. rents that are greater than comparable market rents; and
  2. are within the limitations described in Section 5-12 E below.
- B. **Exception Rent Recommendation.** A PAE may recommend exception rents if
1. the PAE determines that the loss of the project would seriously and adversely impact the tenants and the community, for example, by displacing tenants who would have serious difficulty finding comparable housing, and
  2. the project's NOI is *insufficient* to support:
    - a) reasonable and necessary operating expenses,
    - b) adequate annual deposit to the Reserves for Replacement,
    - c) debt service on any new rehabilitation loan, and
    - d) a reasonable return to the owner. (See Section 3-6 for a discussion of the owner's reasonable financial return.) The Underwriting Model supplies a reasonable method for calculating a possible return to the owner in these cases.
- C. **Sizing Exception Rents.** Exception rents should not exceed the amount necessary to
1. cover the items in paragraph B. 2. above, and
  2. provide a debt coverage ratio which the PAE determines provides a reasonable cushion for future operations.
- D. **Recommendation Against Exception Rents.** The PAE should **not** recommend exception rents if it determines that:
1. continuation of the project would have an irreversible detrimental impact on the community; **or**

2. the project is in poor physical condition that cannot be remedied cost-effectively; **or**
3. the project's owner has been confirmed to be ineligible for restructuring.

**E. Exception Rent Limitations .**

1. Generally, the PAE may not use exception rents on more than 20% of all units in properties accepted in any one year, per PRA. PAEs should analyze their portfolio periodically to determine if the number of units that have been or will be approved which will exceed 20% of the units accepted. If the percentage is expected to exceed 20% for that fiscal year, the PAE must request a waiver using Form 5.1.
2. Generally exception rents may not exceed 120% of the FMR. If required, the PAEs Case Memorandum should clearly state why Exception Rents over 120% of FMR are appropriate. The OMHAR Regional Office will review the request and submit its recommendation to OMHAR HQ in the case of exception rents exceeding 120% of the FMR.
3. The authority to waive the 120% cap is limited to no more than 5% of the units (nationwide) assigned to PAEs under PRAs.

## Sources and Uses

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### SECTION 5-14

**A. Sources.** Sources may include any combination of the following:

1. Proceeds of any new loan.
2. Partial or Full payment of claim.
3. Cash contributions from the owner (partners/investors). *With two exceptions noted below*, owners are required to contribute, in cash, at least 20% of the cost of items in the Rehabilitation Escrow. Of the owner's contribution, three percent (3%) of the cost of items in the Rehabilitation Escrow must come from non-government sources. PAEs should confirm the amount and source of the owner's contribution of non-project funds to the Rehabilitation Escrow. (Note that syndication proceeds from LIHTC awards would not be considered a governmental source and may be used to meet the owner's contribution requirement.)

The two exceptions are: (a) non-profit cooperatives are exempt from this requirement and (b) where the Rehabilitation Escrow includes Significant Additions. Significant Additions are items that are new (not replacements

or repairs) and that are determined necessary by the PAE. They are generally limited to air conditioning, elevators, and new community space. Considering the structure of the transaction, the PAE will generally reduce the owner contribution for the cost of the Significant Additions to 3%. (The contribution may never exceed 20% of the cost of such items.)

4. Excess Project Account Balance. Any Excess Project Account Balance is determined by subtracting the Reserves for Replacement account balance required after closing from the total account balances of the **Reserve** for Replacement, Residual Receipts and any other applicable accounts, at the time of closing.
  - a) 100% of the Excess Project Accounts Balances should be used as a Source.
  - b) If 90% of the Excess Project Account Balance is so large as to remove the need for a partial payment of claim, the transaction will still be processed as a Full and the other requirements of the Restructuring Plan must be met, including a Use Agreement and a Rider to the Section 8 contract. Any funds remaining will be recaptured by HUD.

B. **Uses.** Funds may be used in any combination of the following for the benefit of the project:

1. Pay-down or pay-off of the original UPB.
2. Repair/Rehabilitation escrow.
3. Initial Deposit to the Reserves for Replacement (including the balance prior to closing plus any additional amount that is required under the Restructuring Plan).
4. Up to 10% of the Excess Project Account Balance provided to the owner if part of the Restructuring Plan. Excess Project Account Balances can only be distributed after all required rehabilitation work has been completed satisfactorily, unless the owner applies such funds to owner-paid transaction costs.
5. Transaction Costs.
  - a) PAEs should determine the reasonable, necessary and customary, transaction costs for each transaction. These include, but are not limited to:
    - i. Title search
    - ii. Site Survey (if needed)
    - iii. Recordation, transfer taxes and similar costs

- iv. Prepayment penalties
  - v. Owner's counsel's fees
  - vi. First mortgage transaction fees
  - vii. Closing Escrow Agent's fees
  - viii. Rehab escrow administrator's and inspector's fees, if any
  - ix. Plans and specifications if needed for items in the Rehab Escrow
  - x. New tax and insurance escrows
  - xi. Up to \$15,000 of the purchaser's costs for a market study, PCA, environmental study, and other purchase due diligence
  - xii. Purchaser's legal costs for TPA, partnership agreement, closing, etc.
- b) In general, the owner/borrower will be responsible for paying at least 20% of the transaction costs for a new take-out loan (and in every case, 100% if there is a modification of the existing loan).
- C. The owner/borrower may finance the remainder of the transaction costs through the new first mortgage, provided the mortgage remains within the limits of HUD guidelines, where FHA insurance is being used.

## **Subsidy Layering Review**

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### SECTION 5-15

- A. **Overview.** A subsidy layering review is a review to determine that multiple funding sources on a transaction do not overlap. The purpose is to ensure the efficient allocation of scarce governmental subsidy resources so that no project receives more subsidy dollars than necessary. The PAE will do the subsidy layering reviews for the M2M program and certify to OMHAR that every Restructuring Plan submitted for approval meets HUD's "subsidy layering" requirements. In general, completion of the Restructuring Plan in accordance with the M2M program standards assures such overlaps do not occur.
- B. **Potential Overlapping Funding Sources.** Funding and subsidy sources with potential overlaps include:
- 1. Claims paid in Mark-to-Market restructurings;
  - 2. IRP rehabilitation loans or grants (under section 531 of MAHRA);
  - 3. FHA-insured loans;
  - 4. Low-income housing tax credits;



5. Project-based Section 8 subsidies;
  6. State and local tax-exempt bond financing; and
  7. Other public funds.
- C. **Requirements for Owners.** Owners are required to disclose assistance from other government sources and the financial interests of persons involved in the project. The statement of the sources and uses of funding attached to the Restructuring Commitment must reflect all such sources.
- D. **Requirements for PAEs.** In determining compliance with HUD's subsidy layering requirements, the PAE should:
1. use the comprehensive sources and uses of funding statement as the basis for the subsidy layering review; and
  2. limit project uses in accordance with the guidelines noted in HUD Notice 95-4; and
  3. if necessary, adjust project sources to balance with project uses.

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## Restructuring Plan and Commitment

### SECTION 5-16

- A. **Owner And Lender Input During Underwriting.** The PAE is expected to work with the owner and lender **throughout the process** of developing the Draft Restructuring Plan. (See Chapter 6-2 for more detailed information on owner involvement in the restructuring process.)
- B. **Completion of Underwriting and Due Diligence.** When underwriting is complete, or nearing completion, the PAE may request an OMHAR review of the deal points before presenting a Draft Restructuring Plan to the owner and/or tenants.
- C. **Draft Restructuring Plan.** When underwriting and all other due diligence is complete and a viable Restructuring Plan can be prepared, the PAE will complete a Draft Restructuring Plan Package (see Appendix L). The Package must include a proposed Restructuring Commitment that details the terms and conditions of the Mark-to-Market funding. The PAE must ensure that the draft Restructuring Plan incorporates all necessary support, is consistent both internally and with the terms of any new financing, and generally complies with the underwriting standards of this Guide, including Appendix V, or the PAE has obtained appropriate waivers.
- D. **Second Tenant Meeting.** A second tenant meeting must be held no later than 10 days prior to submission of the Plan in order to allow the

PAE 10 days to address tenant concerns prior to submission of the Draft Plan to OMHAR. See Chapter 3 regarding timing, notices, and provision of materials.

- E. **Submission to OMHAR for Approval.** The PAE will submit the Draft Restructuring Plan to the OMHAR Regional Office for approval. At the time of the submission, the PAE must “submit” the Form 5.2 electronically to the M2M MIS system.

## **Business Forms**

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### SECTION 5-17

- 5.1 Waiver Request - Exception Rents - 20% of Annual PRA Limitation
- 5.2 Case Memorandum Term Sheet